

## Internal Revenue Service

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## Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04

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Date:

December 08, 2014

### Legend

Decedent

Daughter

Granddaughter

Son-in-Law

Daughter's Trust

Individual 1

Individual 2

GG1

GG2

Foundation

Date 1

Date 2

Date 3

Date 4

Date 5

Date 6

Date 7

a

State

State Statute

Dear :

This letter responds to your authorized representative's letter dated June 16, 2014, and subsequent correspondence requesting generation-skipping

transfer (GST) tax rulings with respect to the proposed division and modification of Daughter's Trust, a trust governed by the laws of State.

The facts and representations submitted are summarized as follows:

On Date 1, Decedent executed his will. Article Fourth of Decedent's will provides for the establishment of Daughter's Trust. Article Fourth provides, in relevant part, that after the bequest to Decedent's wife and Foundation, the trust is to be divided into equal parts. One-half of Decedent's property is to vest in Son-in-Law, in trust for the following purposes. The trustee is to hold and manage said one-half of the property for the use and benefit of the beneficiaries herein named as a trust estate. Subject to the other provisions herein, the trust estate herein created shall continue during the life of Daughter and Decedent's wife, but at the death of Daughter, said one-half interest in property shall continue to be held, controlled and managed by Son-in-Law as trustee, or his successor trustee, but subject to the payment of \$a per month for and during the natural life of Decedent's wife, for at least twenty-one years after the death of Daughter and during the life of wife. After the expiration of said twenty-one years and at the death of wife should Granddaughter have no children, the trust is to be turned over to Granddaughter in fee simple. In the event Daughter predeceases Decedent and Granddaughter also predeceases Decedent, but within twenty-one years of the death of Daughter, and shall leave children, the trustee is to continue to manage and control the trust estate for the purpose of paying the bequest to Decedent's wife and for the use and benefit of Granddaughter's children for twenty-one years after the death of Granddaughter, or twenty-one years after the death of Daughter, whichever is longest, after which time the trust fund is to be turned over to Granddaughter's children, share and share alike.

Article Sixth provides, in relevant part, that during the time the trust shall be in existence, the trustee may, from time to time, in his discretion, make advancements to any beneficiary out of the rents, revenues, and earnings of said trust estate, the amounts and time or times of said advancements shall depend on the need of the beneficiary and the discretion of said trustee. Provided, however, that during the time the trust is in force the earnings of said trust shall at any time, within the opinion of said trustee, be inadequate to maintain and support any beneficiary in the manner to which said beneficiary is accustomed said trustee, in his discretion, may advance to said beneficiary out of the corpus of the trust, an amount or amounts from time to time as may be necessary.

Article Seventh provides, in relevant part, that during the time the trust shall be in effect, the last surviving trustee shall have the right to designate a successor trustee by instrument in writing and filed for record in the Deed Records of any county or state in which the subject matter of this trust may be located and said successor trustee shall have all powers, privileges and duties as herein provided for the trustee herein named. In the event, however, that any acting trustee shall resign, die or become incapacitated

to act and shall have failed to appoint a substitute trustee, as above provided, this trust shall not cease but Individual 1, is hereby appointed and constituted trustee and shall have all powers and duties as provided to Son-in-Law.

Decedent died on Date 2, a date that is prior to September 25, 1985, survived by Daughter and Granddaughter. After Decedent's death, Granddaughter had two daughters, GG1 and GG2. Daughter died on Date 3. Granddaughter died on Date 4. Decedent's wife has also died, but her date of death is unknown. Individual 2 currently serves as trustee of Daughter's Trust.

Individual 2 represents that distributions from Daughter's Trust have been made in equal amounts to GG1 and GG2 in accordance with Article Sixth. No distributions have been made to Granddaughter.

On Date 5, Individual 2 filed a petition for declaratory judgment with County Court to construe the terms of Decedent's will, to divide Daughter's Trust into two equal shares, and to make other judicial modifications to Decedent's will. On Date 6, County Court issued an order (Order) granting all relief sought in the petition, conditioned on receiving a favorable ruling on the GST tax issues from the Service.

The terms of Decedent's will are ambiguous with regard to when Daughter's Trust should terminate, how its remaining assets should be distributed upon termination, and how a beneficiary's share of such assets should pass in the event the beneficiary is not then living. The Order construes the will to provide that Daughter's Trust should terminate on Date 7 (twenty-one years after Date 3) and its then remaining assets should be divided equally and distributed to each great-granddaughter, outright and free of trust, or if a great-granddaughter is not then living to such great-granddaughter's estate.

The Order also modifies the terms of Decedent's will with respect to how the terms govern Daughter's Trust. Specifically, the Order divides Daughter's Trust into two equal shares, one share for the benefit of GG1 and one share for the benefit of GG2. The trustee is to administer each share as a separate trust. The trustee is to make distributions of principal and income of each trust in accordance with Article Sixth for the benefit of the great-granddaughter for whom the trust is being administered. Each trust is to terminate upon the earlier of (i) Date 7 or (ii) the date of death of the great-granddaughter for whom the trust is being administered. Upon termination, the trustee is to distribute the remaining trust estate outright and free of trust to the great-granddaughter for whom the trust is being administered, or to her estate if she is not then living. This modification is known as Modification One.

In addition, the Order modifies the terms of Decedent's will with respect to the trustee succession provisions. The Order removes Article Seventh in its entirety and replaces it with a new article that provides, in relevant part, that Individual 2 is to serve

as trustee of each trust created for as long as he is willing and able. Individual 2, so long as he is serving as trustee, or any other trustee while serving, may appoint any one or more persons (other than GG1 or GG2) to act as a co-trustee or as a successor trustee with such powers and duties and subject to such limitations as the appointing trustee may prescribe. With respect to a trust that is administered for the sole benefit of one beneficiary, in the absence of an appointment within forty-five days of a vacancy arising, such beneficiary may appoint a successor trustee (other than the beneficiary). If a successor trustee is not appointed within sixty days of a vacancy arising, the trustee last serving or such beneficiary may secure the appointment of a successor trustee by a court of competent jurisdiction at the expense of the trust estate. This modification is known as Modification Two.

State Statute provides, in relevant part, that on the petition of a trustee or a beneficiary, a court may order that the trustee be changed, that the terms of the trust be modified, that the trustee be directed or permitted to do acts that are not authorized or that are forbidden by the terms of the trust, that the trustee be prohibited from performing acts required by the terms of the trust, or that the trust be terminated in whole or in part, if: (1) the purposes of the trust have been fulfilled or have become illegal or impossible to fulfill; (2) because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust; (3) modification of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or avoid impairment of the trust's administration; (4) the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions; or (5) the order is not inconsistent with a material purpose of the trust. The court shall exercise its discretion to order a modification or termination in the manner that conforms as nearly as possible to the probable intention of the settlor. The court may not take the action permitted by paragraph (5) unless all beneficiaries of the trust have consented to the order or are deemed to have consented to the order.

You have requested the following rulings:

1. The proposed division will not cause Daughter's Trust, as modified, to lose its exemption from the GST tax.
2. Modification One will not cause Daughter's Trust, as modified, to lose its exemption from the GST tax.
3. Modification Two will not cause Daughter's Trust, as modified, to lose its exemption from the GST tax.

### Rulings 1-3

Section 2601 of the Internal Revenue Code imposes a tax on every GST. The term GST is defined in § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. Thus, unless specifically noted, the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the provisions of chapter 13, if: (1) The judicial action involves a bona fide issue; and (2) The construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(i)(E), Example 3, considers a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed *per stirpes*, only to the children of A and B, or *per capita* among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for *per capita* distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates. The court's construction resolves a bona fide issue regarding the proper interpretation of the instrument and is consistent with applicable state law as it would be interpreted by the highest court of the state. Therefore, the trust will not be subject to the provisions of chapter 13.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a

federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving “proper regard” to the state trial court’s determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C)), by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. However, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor’s two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, *per stirpes*. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A’s issue and one for the benefit of B and B’s issue. The trust for A and A’s issue provides that the trustee has the discretion to distribute trust income and principal to A and A’s issue in such amounts as the trustee deems appropriate. On A’s death, the trust principal is to be distributed equally to A’s issue, *per stirpes*. If A dies with no living descendants, the principal will be added to the trust for B and B’s issue. The trust for B and B’s issue is identical (except for the beneficiaries), and terminates at B’s death at which time the trust principal is to be distributed equally to B’s issue, *per stirpes*. If B dies with no living descendants, principal will be added to the trust for A and A’s issue. The division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the

period provided in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

Section 26.2601-1(b)(4)(i)(E), Example 10 considers the following situation. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13.

In this case, Decedent's will established Daughter's Trust for the benefit of Daughter. Decedent's will did not clearly provide for what would happen to the trust if Granddaughter dies with surviving children after the deaths of Decedent and Daughter. Specifically, the will is ambiguous with regard to when Daughter's Trust is to terminate and how the remaining trust assets would be distributed upon termination. The trustee petitioned County Court to construe the terms of the will to provide that Daughter's Trust it to terminate by Date 7. In accordance with State Statute, the trustee may petition a court to change the terms of a trust, with the consent of all beneficiaries, if the order is not inconsistent with a material purpose of the trust. The material purpose of the trust is to administer trust assets for the benefit of Granddaughter's children. This material purpose is furthered by dividing the trust into two trusts, one trust to benefit GG1 and the other trust to benefit GG2. This material purpose is also furthered by providing new trustee succession provisions. We conclude that these modifications are consistent with applicable State law that would be applied in the highest court of State.

Further, the proposed division and modification of Daughter's Trust will not result in a shift of any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division and modification. The proposed division and modifications will not extend the time for vesting of any beneficial interest beyond the period provided for in Daughter's Trust. Accordingly, based on the facts submitted and the representations made, we conclude that:

1. The proposed division will not cause Daughter's Trust, as modified, to lose its exemption from the GST tax.
2. Modification One will not cause Daughter's Trust, as modified, to lose its exemption from the GST tax.

3. Modification Two will not cause Daughter's Trust, as modified, to lose its exemption from the GST tax.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

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Melissa C. Liquerman  
Chief, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures

Copy for § 6110 purposes

Copy of this letter

cc: